1812

1941

Economic Conditions
Governmental Finance
United States Securities

New York, December, 1941

General Business Conditions

THE industrial situation has shown some further irregularity, due chiefly to labor disturbances and to the decline in production of consumers' durable goods. However, defense work continues to increase and industrial operations in the aggregate show no falling off. The Federal Reserve Board's index of production rose three points in October to 164 per cent of the 1935-39 average, which is another high record, and subsequent reports suggest that this level has been maintained despite the coal strike and other interruptions.

Treasury expenditures for defense have increased further during November, on a daily average basis, although it is possible that the month's total will not exceed October, due to fewer working days. Meanwhile the program has been expanded by the President's request for additional military appropriations of nearly $7 billions, which will raise the total program including Lease-Lend to $70 billions. The increase represents another huge demand upon the industries, and among other things will call on the automobile manufacturers for greatly expanded tank production.

The supreme task of the industries, and of every element of the population, is to raise both the national output and the proportion of it devoted to defense. The fact that expansion of defense production has more than offset other declines is an indication that the shift of the industrial organization to defense purposes is proceeding in more orderly fashion than many had believed likely, considering the widespread confusion and the complexities involved. Fears that priority difficulties by this time would be causing more curtailment and unemployment than defense work could absorb have proved to be at least premature. Total employment has risen despite the difficulties of some industries and localities. In many cases stocks of materials accumulated over the past year have enabled industries to avoid or minimize curtailment, even where restricted in obtaining new supplies.

Strikes are the most disquieting feature of the situation. All the industries are interdependent, and shutdowns in one place force curtailment elsewhere, — too often in defense plants. On the whole it is probable that strikes have been doing more to restrict expansion of industrial output than the problems raised by priorities and materials allocations.

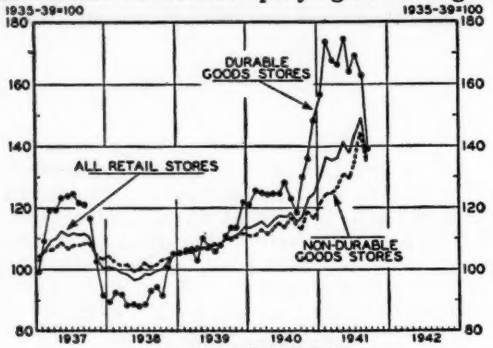
As the period of adjustment continues, more plants are being re-equipped for armament work and new plants are coming into use, providing work for labor that is displaced from its usual occupation. Output of machine tools made a further increase in October, to a rate exceeding $900,000,000 annually. There has never been anything approaching this expansion of industrial capacity, and the belief that "priorities unemployment" will continue to be a local rather than general problem is strengthened accordingly.

Forward Buying Lessens

The heavy forward buying, which has been an almost universal policy over the past year, has subsided somewhat of late, and the business situation will be the more orderly for it. Undoubtedly greater inventories than needed have been built up in some quarters, for protective purposes. Shortages have been magnified thereby. Over-stocking by some buyers, under existing conditions, is often at the expense of others' needs, and not only hampers non-defense work unnecessarily but may impair the defense effort.

In some industries the main reason for the slackening in forward orders is inability to place them, for producers are booked up, supplies are allocated, or sellers are unwilling to make commitments at present price ceilings. However, lessened inducement to buy ahead is also a factor. Buyers are now well stocked. Fears of transportation tie-ups have abated, following the performance of the railroads this Fall in meeting all demands without car shortage. With respect to certain imported commodities, chiefly those from the Far East, the shipping situation has eased, though on other routes it is still tightening.

Moreover, it seems correct to say that wholesalers and retailers, having increased inventories substantially, are disinclined to build them higher, at least in lines where there is no particular shortage. In some goods where the price outlook is less one-sided they are thinking again of market risk. The decline in sales of consumers' durable goods has been greater than generally expected, and has influenced sentiment. In the accompanying chart we give



Indexes of Retail Sales
1935-39 = 100

the record of retail sales as represented by a new index computed by the Department of Commerce, divided between durable and nondurable goods. Durable goods are represented by automobiles, household equipment and furnishings, building materials and hardware, and jewelry.

The Drop in Automobile Sales

The decline in automobile sales has been the chief element in the sharp drop of the durable goods index. When the system of quotas to govern passenger car output was adopted it was thought that the limitations might cause a scarcity of cars. However, dealers' stocks have been mounting above expectations, and are larger than a year ago. It is hardly to be inferred that the sales slackening reflects a lack of buying power, in view of the steady rise of labor and farm income; it appears to be due rather to the fact that buyers had anticipated their wants, to the price advances, and to dealers' unwillingness to make as liberal trade-in allowances as last year. The production quotas for next Spring will represent more severe curtailment than has been enforced so far, the February 1942 passenger car quota being only 44 per cent of the output in the same month this year.

November department store sales have been better than in October, after making the usual allowance for seasonal influences, and mail order and chain store sales also are good. The situation is spotted, however. Defense industrial areas particularly report large gains over last year, but in some cities the department stores' dollar increase has been small, and is wholly accounted for by higher prices.

Despite the impression made by the drop in automobile sales, and uneasiness as to the effects of tax increases, higher food costs and merchandise price advances, retailers expect a heavy holiday business; and there is support for their hopes in the continued rise of national income, which is now at a rate substantially above $90 billions annually. In the past few months the increase in total income payments has been accompanied by an equivalent rise in living costs, and the increase in real buying power therefore has been checked. However, the gain in real income as compared with the holiday season a year ago is very substantial, chiefly among farmers and factory workers.

Price Advance Levels Off

The levelling off of the commodity price advance since the middle of September has been another development contributing to a more orderly business situation. It represents a check to the inflationary spiral, and it weakens the incentive to hoarding. The peak of prices of the 28 basic commodities represented in the daily index of the Bureau of Labor Statistics was reached on September 12, when it stood at 156.9 (August 1939 = 100), and it is currently 155. This halt in basic prices has flattened out the trend of the more inclusive weekly index of 889 commodities, which has advanced less than 1 per cent in the same period, and it will also moderate the rise in retail prices and the cost of living.

This price action is the subject of varying interpretations, the most common being that it is an interlude, correcting over-speculation, in a forward movement which may be resumed at any time. However, it should also call attention to the record-breaking supplies of most basic commodities, the expanding production and the great productive capacity available, as well as to the continuing effectiveness of the price limitations in the areas where shortages exist.

One warning may be offered with respect to this action of prices. It should not induce complacence as to the need for anti-inflationary policies, or win support for such measures as the proposed lifting of farm price ceilings, which was written into the price control bill early in the month by the House Ways and Means Committee. Under this amendment no ceiling could be placed on farm commodities until the highest of the three following levels is reached: (1) 110 per cent of parity, (2) the 1919-29 average, or (3) prices on Oct. 1, 1941. Experts in the Department of Agriculture estimate that adoption of this provision would permit farm prices to rise on the average 20 per cent above present levels. Secretary Wickard has announced his flat opposition to the proposal and Washington reports have indicated that President Roosevelt will oppose it also.

The price control bill is meeting opposition on one hand because it confers too great powers upon an administrator, and on the other because of its plain inadequacies, which include the limitation on control of farm prices and the failure to include any provision for wage control. The broadest ground of all for criticism of the bill seems frequently to be overlooked. That is the unlikelihood that even a strong price control measure can be continuously effective unless it is part of an integrated and consistent anti-inflationary policy.

Such a policy would embrace not only measures which the Administration has already taken in part, including the priorities and materials allocations, tax increases to absorb expanding income into the Treasury, and the effort to increase savings and divert them to the Treasury's use through sales of securities to individuals. It would also include rigorous economy in expenditures and curtailment of non-defense activity within the Government, as within private industry. It would include the release of government stocks of commodities to keep prices down rather than impounding them to keep prices up. It would unquestionably include the encouragement of production in agriculture, mining and industry by every possible measure and attitude that could be brought to bear.

Before putting too great dependence upon price control the interdependence of all these elements in the situation should have more consideration. It is clear that the most effective way to control prices is to have buyers restrict their purchases, if not by voluntary action, then by allocation of materials and diversion of more of the national income to the Treasury. The situation is one for co-operation by individuals, as well as for government direction.

The Labor Crisis

For a long time it has been apparent that the labor situation was drifting towards a crisis. The difficulties in which the country finds itself are not, as everyone knows, of recent origin. The cost to the country of industrial disunity was already a heavy one when the defense program was started. Probably no other single factor has contributed more to the undermining of confidence, the discouragement of enterprise, and the persistent unemployment, with its heavy toll of continuing relief expenditures and mounting federal debt.

It is not merely that production has been impeded by strikes and kindred labor difficulties, and costs raised by repeated wage increases. More important, perhaps, has been the psychological effect upon business men and investors of the growing economic and political power of labor without clear indication as to how far such power may reach. Uncertainty—whether it be in respect to labor, taxes, or many other factors affecting business—is always one of the most paralyzing influences that business men have to face. For until business can know and take the measure of what it has to meet, it has no basis for going ahead.

Serious as are the consequences of industrial strife in time of peace, they become still more serious in time of national danger. Our people have watched with growing anxiety the interruptions to the vital flow of war materials at a time when the national security demands every possible ounce of energy for preparedness.

Costly as strikes heretofore have been to various parts of the defense program, it has still been possible to muddle along with temporizing expedients, and by virtue of our enormous productive capacity turn out an immense amount of materials. But confronted at last by threats of suspension in such basic industries as coal and the railroads, there would seem to be no longer any question as to the necessity of evolving a program upon which management and labor can unite wholeheartedly in the supreme task of the moment—making the United States safe against any possible foe.

The Long and Short Term Problems

In considering the problem of industrial relations, it becomes obvious at once that there is both a long-term and a short-term aspect. The long-term problem is evolutionary in character and has to do with fundamental changes in the relationships between employers and employes in industry. It concerns such questions as the right of workers to organize, the right to strike, the closed vs. the open shop and all the variations in between, collective bargaining, arbitration of wage and other disputes, etc. It is not the purpose of this article to enter into debate over these highly controversial problems, but merely to point out that these problems exist and that ideas upon them are undergoing change, in this country as they have in other countries.

It is well to recognize frankly that these changes are taking place, and indeed that some degree of change is inevitable as the country grows more mature and the economic system more complex. There is, after all, very little that is immutable in human relations. Nor need we be surprised or lose heart if the process of change is not altogether a serene or peaceful one. Departures from established practices in any field are quite likely to cause a certain amount of friction. Moreover, these are issues upon which people feel deeply, and in which apparently conflicting economic interests are involved. There is, unfortunately, no clearly charted route in the complicated area of industrial relations. We can only feel our way forward by a gradual process of trial and error, learning from experience as we go along, curbing extremists, and relying always

upon the good will, common sense and fairness of the vast majority of those concerned.

There is reassurance, in moments of discouragement, in the realization that other countries have faced similar crises and surmounted them; and that even in our own country there have been times past when the contemporary discussions of labor troubles read amazingly like what we see and hear today. For example, the American correspondent to the London Economist refers in the issue of October 19, 1907, to labor as the principal cause of prevailing uncertainty. "Labor," he asserts, "still demands its pound of flesh and the exactions from this quarter weigh heavily upon both industrial and railroad corporations, not only through the increased wage, but also because of the growing inefficiency of the workmen." "The inefficiency and exactions of labor," he writes "have brought about a condition where the employer is practically losing control of his own business."

This might be parallelled many times in our history, yet always — despite at times the bitterest controversies — new relationships have been worked out under which it has been possible for the country to go forward to new levels of prosperity.

Attitude of Government

It seems a good rule under ordinary circumstances for government to allow management and men to work out their problems with the least possible interference or pressure. There is an old saying about third parties not getting mixed up in family quarrels that seems to apply to industrial disputes. There is of course, a part that government can usefully play in mediating disputes and assuring orderly procedure; but to go beyond this role involves danger of confusing the issues in politics, pressing reforms that are either ill-conceived or come too fast for the system to accommodate itself to them, and intensifying ill feeling.

Above all it would seem to be axiomatic that government should guard scrupulously against partisanship and unfairness on its own part in dealing with these problems. Actually the Government has not been fair, but in the Wagner Act and in its administration by the National Labor Relations Board has attacked "unfair practices" on the part of employers, while failing to recognize or deal adequately with "unfair practices" on the part of labor. While the revolutionary sit-down strike is now generally conceded to be illegal, there is still toleration of such abuses as the breaking of contracts, strikes resulting from jurisdictional disputes between unions, racketeering, mass picketing and intimidation, etc.

In contrast with this attitude, the British Trade Disputes and Trade Unions Act, passed after the general strike in 1926, recognizes and attempts to regulate certain unfair practices on the part of labor as well as management, including sympathetic strikes and intimidation, while in this country the State of Wisconsin's Employment Peace Act, enacted in 1939, likewise gives recognition to the fact that labor as well as management may err. The one-sided labor policy of the Federal Government has contributed greatly to the industrial turmoil of recent years, and any long range solution of the labor problem must rectify such inequalities and injustices.

The Immediate Problem

The immediate problem, however, is not one of working out long range solutions, but of avoiding any interruptions of production and distribution during the present emergency. The highly-charged atmosphere of a national crisis is not suitable for the settlement of fundamental issues in a field as difficult and controversial as labor relations. It would seem, therefore, both logical and fair to postpone, wherever possible, such questions until after the emergency has passed.

We have ample precedent for such a program both in the policies adopted in this country during the last war and those adopted in Great Britain and Canada during the present war. In the last war there was created here a National War Labor Board by the Wilson Administration. In establishing this Board, a preliminary conference board consisting of representatives of five of the largest employers, and five national officers of unions engaged in war production, together with ex-President William H. Taft and the Hon. Frank P. Walsh as co-chairmen, drew up a report embodying a set of guiding principles which may be summarized as follows:

There should be no strikes or lockouts during the war.

Right to organize. 1. The right of workers to organize in trade-unions and bargain collectively, through chosen representatives, is recognized and affirmed.****

2. The right of employers to organize in associations or groups and to bargain collectively, through chosen representatives, is recognized and affirmed.****

3. Employers should not discharge workers for membership in trade-unions, nor for legitimate trade-union activities.

4. The workers, in the exercise of their right to organize, shall not use coercive measures of any kind to induce persons to join their organizations, nor to induce employers to bargain or deal therewith.

Existing conditions. 1. In establishments where the union shop exists the same shall continue and the union standards as to wages, hours of labor and other conditions of employment shall be maintained.

2. In establishments where union and nonunion men and women now work together, and the employer meets only with employees or representatives engaged in said establishments, the continuance of such condition shall not be deemed a grievance. This declaration is not intended to deny the right or discourage the practice of formation of trade unions * * * but employers are not obliged to further unionize their plants.

3. Established safeguards and regulations for the protection of the health and safety of workers shall not be relaxed.

Women in industry. If it shall become necessary to employ women on work ordinarily performed by men,

they must be allowed equal pay for equal work and must not be allotted tasks disproportionate to their strength.

Hours of labor. The basic eight-hour day is recognized as applying in all cases in which existing law requires it. In all other cases the question of hours of labor shall be settled with due regard to governmental necessities and the welfare, health, and proper comfort of the workers.

Maximum production. The maximum production of all war industries should be maintained and methods of work and operation on the part of the employers or workers which operate to delay or limit production, or which have a tendency to artificially increase the cost thereof, should be discouraged. * * * *

Custom of localities. In fixing wages, hours and conditions of labor regard should always be had to the labor standards, wage scales, and other conditions, prevailing in the localities affected.

The living wage. (1) The right of all workers, including common laborers, to a living wage is hereby declared.

(2) In fixing wages, minimum rates of pay shall be established which will insure the subsistence of the worker and his family in health and reasonable comfort.

This statement of principles and policies to govern relations between workers and employers in war industries for the duration of the war was signed by all twelve members of the conference board, who became the members of the National War Labor Board upon its formal establishment.

It will be observed that the general policy so far as organizational problems were concerned was one of maintenance of the status quo, neither employers nor employes expecting to gain new advantages over each other during the emergency. This policy worked successfully until the Board was dissolved in August, 1919. During the sixteen months of its existence, the Board heard over 1,200 cases, and made awards and findings directly affecting more than 1,100 establishments employing more than 700,000 people. Though the Board lacked legal power to enforce its decisions, its high prestige, backed by the powers of the Administration and by public opinion, gave weight to its decisions. Quite apart from the cases immediately involved, its decisions and the principles which it enunciated had an effect in establishing a code of fair conduct that exerted an influence far wider than the figures indicate.

Great Britain and Canada

In Great Britain in the current war, the same principle of subordinating group interests to the national welfare has been widely recognized. Under legislation adopted in 1940 there was established a national arbitration tribunal for dealing with disputes that cannot be settled by the existing conciliation machinery, and decisions by this body are binding on both parties. While the government has not established control over wages, it has obtained voluntary concessions from the unions with regard to such important questions as working hours, mingling of skilled with unskilled workers, closed shop, entrance of women in industry, etc. Such concessions are understood to be for the war period only, except as they may be extended by post-war arbitration tribunals with the consent of both parties.*

In Canada, the Industrial Disputes Investigation Act passed back in 1907 set up machinery for conciliation, fact finding and the making of recommendations in disputes in the coal mining, transportation and public utilities industries. With the outbreak of the war in 1939, this machinery was extended and made compulsory for all defense industries. No strike action may be taken until the Conciliation Board has submitted its report — and then only if in a vote taken under Department of Labor auspices a majority of those eligible to vote are in favor of a strike. In the matter of wages, Canada has decreed strict controls as part of its general plan of price control. Except in certain industries, wage rates are to be determined by a National War Labor Board, with adjustments to be made in accordance with changes in the cost of living.

U. S. Lacking Consistent Labor Policy

In contrast with the situation here in the last war and the present situation in Great Britain and Canada, the United States has had no consistent policy in dealing with labor problems during the emergency, unless it has been a policy of having no policy. The National Defense Mediation Board has not only been unwilling to adopt the "status quo" principle followed so successfully by the Labor Board in the last war, but has not laid down any other guiding principles. It has insisted that "each case would be decided on its own merits. Instead of forestalling and discouraging industrial disputes, as a broad statement of policy might have done, the Board's insistence upon settling each case "on its merits" has constituted in effect an invitation to labor everywhere to come and see what it could get. As was bound to occur in these circumstances, the decisions of the Board have caused confusion and accusations of inconsistency, including the alleged inconsistencies cited by the minority report of the Board's C.I.O. members in the captive coal mine case.

Due to this policy of drift, the situation has at length gone to the point where products and services vital to the national defense are involved. It is evident that the patience of the country has been exhausted, and while it would have been far better could these matters have been handled without additional legislation involving prohibitions and penalties, Congress seems now prepared to take action to assure continuance of operations in defense industries. For some time a number of bills have been pending in Congress awaiting word from the Administration, including a bill presented to

* "British Labor and the War" by Frieda Wunderlich, New School for Social Research, New York, 1941.

the House Labor Committee by Representative Ramspeck of Georgia, which would be based on compulsory arbitration of labor disputes if conciliation and mediation during a "cooling off" period failed; and a bill offered by Representative Howard Smith of Virginia which would freeze existing open and closed shop arrangements and would prohibit mass picketing and jurisdictional, sympathetic, and boycott strikes.

That the country is in a mood to support legislative action looking towards the maintenance of industrial peace seems to be the clear indication of recent polls of public opinion. These showed that while 67 per cent of those polled favored the existence of trade unions, 73 per cent opposed strikes in defense industries, 60 per cent opposed the coal walkout in particular, and 78 per cent favored a vote by secret ballot under government supervision before a strike may be called. The National Grange, one of the leading farm organizations, at its annual convention on November 18 adopted a resolution calling upon Congress to take immediate steps "to prevent and prohibit all strikes which would retard progress of defense industries." The resolution was passed by a unanimous vote of seventy-three delegates from thirty-seven states attending the convention.

Dual Nature of Immediate Problems

In searching for a fair and equitable solution of these issues, it must be recognized that the problems fall in two classes. First, there are the problems of fundamental relationships between employers and employes and between different trade unions. The problems involved in the coal dispute are solely of this character. These in most cases can be very well settled, as they were in the last war, on the basis of maintaining the status quo for the duration of the emergency.

Second, there are the more complex problems of dealing with wages in a setting in which employment, prices and living costs are undergoing rapid changes. The issues involved in the railroad labor controversy fall into this classification. The problem of wage adjustments in the railroad or any other major industry, however, must be considered as part of a broad national program for dealing with the danger of inflation. This was stated clearly by the Railroad Labor Board in its report on the wage dispute, when it pointed out that

> Effective attack on the problem can only be made for all classes, groups and industries. Such a comprehensive attack, if it is going to be made at all, must be made by the Government. It must grow out of a carefully formulated and well coordinated plan covering prices, wages, profits, taxes, credit, investment and priorities.

"It is impossible," said the report, "to make a satisfactory decision on labor policy in a single industry under the circumstances which confronted this Board." It is this problem that has led many people to advocate an over-all control of prices and wages, the principles of which have been embodied in the Canadian plan of regulating all prices and adjusting wages in accordance with cost of living changes.

Rights of the Public

And, finally, there is this further to be said: in all disputes between employers and employes, as between other groups in the community, there rests upon all a common obligation to the general public welfare. Society can exist on no other basis. Unless individuals are willing to recognize that there are certain obligations imposed upon them as members of the group for the common good, and transcending private interests, there can be no orderly existence, no security or rights for anyone.

This does not mean, of course, that there are not private rights that society is bound to respect. The existence of such rights constitutes the essence of free democracy and distinguishes the democratic system from totalitarianism where the interests of the State are all pervading. The rights of democracy, however, do not include the right of individuals, or groups of individuals, to indulge in actions that are inimical to the security and well-being of the people as a whole. President Woodrow Wilson, on the occasion of another threatened general bituminous coal strike, expressed the case in clear and forceful terms in a public statement issued October 25, 1919, from which we quote in part as follows:

> From whatever angle the subject may be viewed, it is apparent that such a strike in such circumstances would be the most far-reaching plan ever presented in this country to limit the facilities of production and distribution of a necessity of life and thus indirectly to restrict the production and distribution of all the nesessaries of life. A strike under these circumstances is not only unjustifiable, it is unlawful.
>
> The action proposed has apparently been taken without any vote upon the specific proposition by the individual members of the United Mine Workers of America throughout the United States, an almost unprecedented proceeding. I cannot believe that any right of any American worker needs for its protection the taking of this extraordinary step, and I am convinced that when the time and manner are considered, it constitutes a fundamental attack, which is wrong both morally and legally, upon the rights of society and upon the welfare of our country. I feel convinced that individual members of the United Mine Workers would not vote upon full consideration, in favor of such a strike under these conditions.
>
> When a movement reaches the point where it appears to involve practically the entire productive capacity of the country with respect to one of the most vital necessities of daily domestic and industrial life, and when the movement is asserted in the circumstances I have stated and at a time and in manner calculated to involve the maximum danger to the public welfare in this critical hour of our country's life, the public interest becomes the paramount consideration.

Later, in his annual message to Congress on December 2, 1919, President Wilson again discussed the rights and obligations of minority groups, declaring as follows:

> The right of individuals to strike is inviolate and ought not to be interfered with by any process of government, but there is a predominant right and that

is the right of the government to protect all of its people and to assert its power and majesty against the challenge of any class. The government, when it asserts that right, seeks not to antagonize a class but simply to defend the right of the whole people as against the irreparable harm and injury that might be done by the attempt by any class to usurp a power that only government itself has a right to exercise as a protection to all.

These words were uttered after a great war and when the victory had been won. How much more significant their purport today when the country is striving to prepare itself against new and even greater dangers.

At its annual convention last month, the Congress of Industrial Organizations, while adopting resolutions supporting the Administration's foreign policy, also heard its president, Mr. Philip Murray, declare that "nothing must stop the work of organizing the unorganized in America — not even a great national emergency." Happily there were other voices raised in the convention, urging the paramount needs of the defense program above any narrow or selfish group interests, and Mr. Sidney Hillman, associate director of the Office of Production Management and president on leave of the Amalgamated Clothing Workers, in a recent address urged a truce upon strikes, stating:

Labor must learn to settle its disagreements with management by using ample government machinery which exists for the fair and equitable adjustment of labor-management differences.

Labor must learn to settle its family quarrels without work stoppages . . . without jeopardizing our national security.

We must not indulge in the suicidal practice of raiding when the very existence of our free labor movement is at stake . . . Shall it be said of labor that when our country needed arms we gave it jurisdictional feuds and bickering among ourselves?

That labor is as vitally concerned in the objectives of the defense program as any other group could hardly be illustrated more impressively than by the following quotation from a recent press dispatch from conquered France:

Vichy, Oct. 27—The Government abolished all political and sectarian trade unions today and ordered all French employers and workers alike to join new Government-controlled labor "corporations."

Strikes and lockouts were outlawed and arbitration was made compulsory under the new labor statute, which was published in the official journal after 15 months' work by French labor experts.

Money and Banking

The decline in prices and advance in yields of U. S. Treasury notes and bills during recent weeks is a development of more than ordinary significance, when considered in conjunction with changes in the New York banking position. Since the outbreak of the war periods of weakness in Treasury securities have been due mainly to unsettlement of sentiment, as in the middle of 1940 on the German victory in France and the beginning of the armament program; and the event showed that they ran counter to the underlying money market trend.

In the present case, however, the causes of the change evidently are within the money market itself. The chief cause is the reduction in excess reserves of the New York City banks. When cash available for investment declines, the natural medium for adjustment of the banks' position is the market for Treasury bills and notes; and any indication that New York banks may be less eager subscribers to forthcoming issues is of course a major influence on the price. New York banks are the most important market for these securities, and hold more than all other banks combined.

The accompanying table gives the changes in prices and yields, since October 1 this year, of a selected list of Treasury securities. The quotations show the graduation of the price changes, from considerable declines on the short maturities, which are largely held within the banking system, to actual advances in the longer terms, which are held more widely by private investors, insurance companies and other savings institutions.

Government Securities
Quotations on Nov 26, 1941

Coupon	Maturity	Asked Price**	Yield to Call	Change Since Oct. 1 Points**	Change Since Oct. 1 Yield
90 day Treasury Bills		——	0.267†	——	+0.265
1¾	3/15/42	101.4	—39/64‡	— .31	§
2	9/15/42	101.25	— 6/32‡	—1.7	§
1¾	12/15/42	102.2	—15/64‡	— .30	§
1⅛	6/15/43	101.10	0.28	— .22	§§
1	9/15/43	101.7	0.32	— .22	+0.30
1⅛	12/15/43	101.18	0.36	— .23	+0.28
1	3/15/44	101.7	0.46	— .28	+0.32
¾	6/15/44	100.18	0.53	— .29	+0.33
1	9/15/44	101.7	0.56	— .29	+0.28
¾	3/15/45	100.18	0.58	— .25	+0.22
¾	12/15/45*	99.22	0.82	— .24	+0.18
3	6/15/48-46	108.31	0.97	—1.2	+0.15
2	12/15/47	105.22	1.03	— .3	unchanged
2½	9/15/48	108.14	1.20	— .2	—0.02
2½	12/15/53-49	108.4	1.43	+ .19	—0.09
2¾	6/15/54-51	110.15	1.56	+ .22	—0.10
2½	3/15/54-52*	106.2	1.85	+ .3	—0.01
2	6/15/55-53	105.9	1.50	+ .21	—0.06
2¼	6/15/56-54	107.3	1.62	+ .26	—0.08
2⅞	3/15/60-55	112.2	1.85	+ .21	—0.06
2½	3/15/58-56*	104.27	2.10	— .6	unchanged
2¾	9/15/59-56	111.12	1.87	+ .19	—0.05
2¾	6/15/63-58	111.15	1.93	+ .16	—0.04
2¾	12/15/65-60	112.6	1.97	+ .24	—0.05

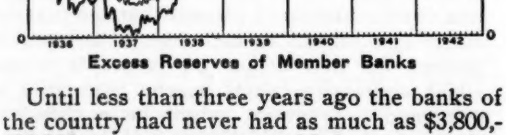
NOTE: Yield is calculated to call date where issues are callable and to maturity on those issues that are not callable. * Subject to all federal taxes. ** Figures after decimal are 32nds. † Average yield on weekly offering nearest date given. ‡ Premium in excess of zero yield to maturity. § Changes are in negative terms. §§ Change from negative to positive yield.

There have been, of course, other contributing causes of the declines shown. One was the increase in the weekly Treasury bill offering from $100,000,000 to $200,000,000, of which one-half represents new borrowing. Another was the circulation of reports that the practice of giving a "right" to exchange maturing obligations for new issues on favorable terms, which ordinarily causes nearby maturities to command a premium, might be modified in some way to diminish the value of the "rights." This talk has been circulating ever since the 1¼ per cent notes due December 15, which were refunded through an exchange offering October 9, went to a premium of more than 3 points.

Secretary Morgenthau's announcement in October, that all borrowing of federal agencies, hitherto in guaranteed form, would be covered by direct Treasury issues, was interpreted by some as an indication that "rights" might be terminated. However, in the first move under this program "rights" to exchange into a Treasury note were given to holders of R.F.C. and C.C.C. notes maturing in November, and the maturing issues sold at a moderate premium. The Secretary announced Nov. 27 that in addition to a $1,500,000,000 new money offering early in December, an exchange offering would be made early in January, to refund a total of $1,075,000,000 of agency and Treasury securities, maturing in January and March. This implies a continuation of right values on maturing obligations.

Decline in Excess Reserves

The drop in excess reserves of the New York City banks has been going on throughout the year, and especially since the Spring months. On November 1st the increase in member bank reserve requirements, previously ordered by the Board of Governors of the Federal Reserve System, went into effect. This action of itself reduced excess reserves of the New York City banks by $480,000,000, and of the member banks as a whole by $1,170,000,000. Subsequently excess reserves increased somewhat, due principally to outpayments by the United States Treasury. However, the total for all member banks on November 26, which was $3,800,000,000 represented a decline of $3,100,000,000 from the year's peak of $6,900,000,000 reached on January 15, and was the lowest in almost three years. Nearly all of this decline, except the part represented by the increase in reserve requirements, has occurred in New York City, where the excess on November 26, was $1,090,000,000 or $2,455,000,000 below the January 15 figure of $3,545,000,000.



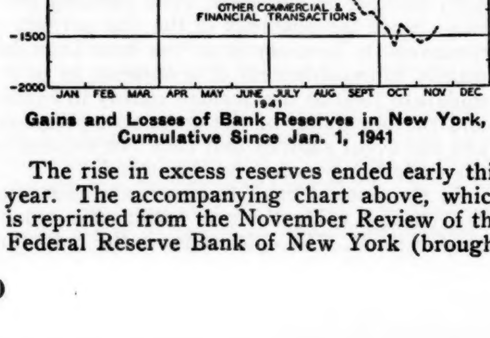
Excess Reserves of Member Banks

Until less than three years ago the banks of the country had never had as much as $3,800,000,000 excess reserves; and it is apparent that the present total, which constitutes a base upon which loans and investments could be expanded by $15 to $20 billions, represents a very strong cushion against substantial change in the money market. The difference in the situation, as compared with other periods when the total was around the present level, is in the distribution of the excess, and in the trend. New York City banks three years ago had approximately 60 per cent of the total while recently they have had only about 25 per cent, and the trend is now downward instead of upward.

Even with total funds superabundant, a decline of such magnitude in excess reserves of the principal money market, within less than a year, could hardly have occurred without some effect on money rates. Excess reserves are never equally distributed among banks, and the lower the totals the nearer is the point where some banks find it desirable to make changes in investment policy or take other measures to maintain their cash position.

Loss of Funds by New York Banks

The relatively large decline in New York's excess reserves as compared with the rest of the country has been due chiefly to two causes. One is the loss of funds from New York to other Federal Reserve districts, which in fact has been heavy for almost two years. The other is the slackening of gold imports, which during 1939 and 1940 had offset by a wide margin, and to the general view had obscured, the losses on other transactions. From the Munich crisis to the end of 1940 nearly $8 billions of gold imports were paid for in the New York district, the proceeds of which added largely to the reserves of the New York banks. Concurrently loans and investments were expanded, and rapidly rising deposits increased reserve requirements; but despite these trends and a steady redistribution of funds, excess reserves of New York City banks during the period rose by well over $2 billions. Correspondent bank balances in New York rose during the same period, reflecting the abundance of funds throughout the country.



Gains and Losses of Bank Reserves in New York, Cumulative Since Jan. 1, 1941

The rise in excess reserves ended early this year. The accompanying chart above, which is reprinted from the November Review of the Federal Reserve Bank of New York (brought

up to November 19 through figures supplied by that Bank), shows movements of funds in and out of New York reserve balances since the beginning of 1941, and reveals the preponderance of losses. It shows the slowing down of the gold movement, imports paid for in the New York district to date in 1941 having been less than $500,000,000. Meanwhile New York banks continued to expand loans and investments, which have increased by approximately $1,800,000,000 durning the year; and, as the chart shows, a substantial part of the proceeds of these loans and investments, along with other funds, has been transferred to other districts, both through Treasury and private transactions. The Treasury ordinarily disburses less money in New York than it receives here from borrowings and taxes, since the bulk of its payments are made elsewhere. To a great extent this is true of private borrowing as well.

The flow of funds into New York, on the other hand, has been retarded by a number of influences, chief of which is that the money is more needed elsewhere. Correspondent bank balances ceased to grow as excess reserves reached their peak, and lately have declined, mainly because of effects of the increase in reserve requirements. Many corporations doing a nationwide business tend to keep larger working balances in other centers. The lack of an interest return on demand deposits, payment of which was forbidden by the Banking Act of 1933, and the declining importance of the short-term paper (except governments) and call money markets, limit the inducement for banks and others to concentrate funds in New York.

During the remaining weeks of 1941 a further drop in excess reserves is to be expected, due to seasonal withdrawals of currency from the banks. After the turn of the year at least part of the currency withdrawn should be redeposited. In the long run, however, further expansion of bank loans and investments, which is virtually certain with respect to investments at least, will reduce excess reserves further, except as their effect may be offset by gold imports or a return of currency from circulation. Both of these are problematical. With Treasury transactions spreading funds over the country and some correspondent banks probably adjusting their own position by drawing on their New York balances, New York may continue to bear the brunt of any decline.

Position of the Money Market

If banking changes follow this course, the market for Treasury securities provided by the New York banks will naturally be more limited than heretofore. The situation to some extent will provide its own correctives. Normally, restoration of the balance between New York and interior money markets would be accomplished in much the same way as in the case of a nation which experiences an adverse balance of payments,—namely, through an increase of exports relative to imports, which would bring in more funds, and a higher interest rate. Adjustment could be made through sales of securities by New York to the interior; a reduction of new security purchases in New York would have the same effect. This, however, might be expected to affect the rate on new issues.

There have been many indications that the Treasury is not averse to firmer short money rates, which from the viewpoint of general economic conditions are for many reasons desirable. Higher rates may tap funds which heretofore have been withheld from investment. An interesting example is a declining trend in foreign deposits in the Federal Reserve Banks, presumably reflecting purchases of short-term governments. But how far the Treasury would be willing to see rates advance without taking counteraction is problematical. Such action, if eventually deemed in the general interest, might take the form of purchases of securities from the New York member banks by the New York Federal Reserve Bank. It should be emphasized, however, that excess reserves in New York are still so large, and the possibility of readjustments is so great, that such an open market operation would hardly be contemplated under present conditions.

It is interesting to speculate, though impracticable to draw conclusions, as to the probable situation at the March 15 tax date, when corporate and individual income tax payments in New York City will require a transfer of funds from banks to the Treasury of unprecedented magnitude. If New York's excess reserves at that time should be inadequate to cover the temporary loss of funds involved in these payments, a temporary squeeze on the money market would result. However, measures to avert such a squeeze could readily be taken. The Treasury could put the banks in funds by allowing its own balances in the Reserve Banks to drop substantially prior to March 15. Large maturities of bills could be arranged to fall on the tax date. It might be possible to permit checks for tax payments drawn in favor of the Treasury to be credited to government deposits in the member banks instead of paid into the Federal Reserve Banks.

Within the past few weeks commercial banks both in New York City and outside have been resorting more to the "book credit" method in payment for government securities, and the privilege of using it has been extended to the weekly bill offerings. Of course banks cannot count on retaining a large volume of government deposits indefinitely under present conditions, but "book credit" can ease the situation effectively in times of temporary money market strain, by avoiding large withdrawals to pay for government securities.

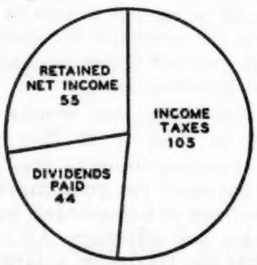
Other measures are open to the Treasury to prevent undue tightening of the money market, and the many variables in the situation make further developments difficult to predict. Over the longer term, important factors will be the degree of success in selling securities outside the banking system, as well as Treasury and Federal Reserve policy. It should be emphasized again that the abundance of total bank reserves, in the country as a whole, is a cushion against violent change in the money position, and over and above the present reserves lie the extensive powers of the monetary authorities to bolster the market in other ways.

Corporate Profits, Taxes and Working Capital

Comments frequently made upon increases in corporate earnings over a year ago seem, in many cases, to reflect a belief that these earnings represent cash that would be available to pay still larger taxes or to increase wages and dividends. There appears to be a rather widespread misunderstanding as to the nature of reported earnings, and failure to recognize that the "net profits" may not be in the form of cash but be tied up in other assets necessary for handling the expanded volume of business.

Because of the importance of this question we have made an analysis of the reports of a group of 80 large industrial corporations, for which comparative balance sheets of December 31, 1940 and September 30, 1941 are available, in an attempt to determine the extent to which this year's earnings have gone into increased inventories, receivables and other assets.

The group reported net income for the first nine months of approximately $204 millions, before taxes. Of this total, as indicated by the diagram, reserves for federal income and excess profits taxes took $105 millions, or more than half, while dividends amounting to $44 millions were paid on the preferred and common stocks, leaving a balance of $55 millions net income for corporate purposes.



Distribution of Net Income before Taxes of 80 Leading Industrial Corporations in the First Nine Months of 1941. In Millions of Dollars.

In every period of expanding business, most companies must increase their investment in inventory, receivables, etc. The necessary funds must be provided either by the liquidation of other assets, by the sale of additional capital stock, by borrowing or by retaining a portion of earnings. Taxes, wages and dividends of course have to be paid in cash. A comparison of balance sheet figures for the group reveals that while retained net profits amounted to $55 millions during the first nine months of this year, the gain in cash was only $15 millions, while other assets increased $136 millions, as shown by the following table:

Increase in Assets, Liabilities and Capital of 80 Leading Industrial Corporations in First Nine Months of 1941.

(In Millions of Dollars)

Increase in Assets		
Cash	$15	
Receivables	59	
Inventories	51	
Property, net	10	
Other assets	16	
Total		$151
Increase in Liabilities and Capital		
Reserve for taxes	$61	
Other liabilities and reserves	35	
Total liabilities		96
Capital and surplus		55
Total		$151

The increase of inventories and receivables reflects in part the heavy expansion in volume of sales, to which they tend to bear a fairly constant relationship and which were 30 per cent larger than in the corresponding period of 1940. Danger of rising prices and shortage of some materials also induced inventory accumulation. There were increases also in plant and equipment in order to add productive capacity, and in miscellaneous assets (including tax anticipation notes, marketable securities, fixed investments, etc.)

Funds with which to finance this increase of $151 millions in total assets came to the extent of $55 millions from the retained net income. The $96 millions balance represented a net rise in corporate liabilities for accounts and notes payable (including bank borrowing), accrued taxes, and miscellaneous liability and reserve items. The diagram and table illustrate the marked difference between the financial results as shown by the customary method of reporting net income, and the actual source and disposition of funds.

Although the available figures from this limited group of large companies may not be typical of conditions throughout the manufacturing industries, they give at least some indication as to the extent to which capital is being tied up in inventories and other assets. The figures show — without going into accounting detail — why current undistributed earnings can by no means be regarded as "free and

clear" when proposals are considered for higher corporate taxes, wages or dividend payments. To take such earnings for any of these purposes would merely involve going further into debt to raise the necessary cash, or raising capital in the market at a time when that market is poor. There is always danger in times of active business of expanding indebtedness that has to be paid off in times of depression.

Already the need to conserve cash appears to be reflected in the reduction of dividend payments by a number of large companies, despite the generally upward trend of earnings and dividends for business as a whole.

Taxation and the Economic Machinery

In connection with proposals for further increases in corporate taxes, it should perhaps be emphasized again that taxing corporate profits means taxing the economic machinery, and that a paramount consideration is the maintenance of this machinery in working order.

There is now general agreement, at least in principle, that no one should make an unseemly profit from the war effort but in the application of that principle to corporation profits some careful analytical thinking is highly desirable. Corporations are not individuals and corporate profits can reach the pockets of individuals only through dividend, wage and salary payments which are themselves subject to taxation, and in the case of large shareholders very large taxation. Corporations constitute the basic economic machinery of this country and tax policy relating to them should have an eye not only on proper support to the government but on the maintenance of the machinery in good working order, both from the point of view of the defense effort and the post-war requirements.

It may be recalled that at the conclusion of the first World War the corporations of this country came through the war so heavily in debt and so loaded with inventory, which suffered from price fluctuations, that the stage was all set for deflation and depression rather than for the launching of new enterprise which would put to work the men and women released from war service. The result was the depression of 1921 which was severe but fortunately short-lived.

The same danger will face us in coming months though there are certain important differences in the situation. Corporations fortunately began this period in more liquid condition than at the time of the previous war and generally speaking with smaller debt. Prices, so far, have been held under better control. On the other hand the tax burden upon corporations is far heavier than it was in the last war and there is danger that this tax burden may force many corporations into a position of indebtedness which may impair their effectiveness of operation.

Already the present federal taxes, in the case of many large American corporations, are as high as those in Canada. Under our Revenue Act of 1941, excess profits taxes on large corporations run up to a maximum of 60 per cent on the excess over the "average earnings" or "invested capital" base, while on the remaining net income the normal tax is 24 per cent and the new surtax 7 per cent, so that the total effective rate in the highest bracket may reach 72 per cent.

Canada's war profits tax provides for a flat levy of 75 per cent on all net income above an "average earnings" base, and a normal tax of 18 per cent on the remainder, or, as an alternative, a straight 40 per cent for a company having little or no excess profits. The Canadian law permits (which the U. S. does not) the filing of consolidated returns for normal as well as excess profits taxes, by which the loss of one subsidiary may be offset against the profits of another, upon payment of 2 per cent higher normal tax. For many companies whose increase in net income has been moderate this year, the tax payable in Canada would be appreciably smaller than that payable here.

In Great Britain, the corporate rates provided for in the 1941-42 budget are 100 per cent on profits in excess of "standard earnings" (representing average earnings in one of three base periods, or earnings which cover preferred dividends plus 6 per cent on common stock), but with 20 per cent of the excess profits tax credited for return after the war, while on the remaining net income the basic rate is 50 per cent. Although the British rates on corporate income are still stiffer than those here, the British local and miscellaneous federal taxes are considerably lower.

It is noteworthy that such London publications as the Economist and the Financial News have recently raised the question as to whether corporate taxation has not been carried to excessive lengths in England, and whether somewhat lower rates might not help to step up further the national production.

End

n U.S.A.